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THE INDEMNITY
AND
ITS EFFECTS ON TRADE

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This Memorandum has been prepared at the instance of the BRITISH NATIONAL COMMITTEE by the economic department of *The New Commerce*. The Editor of *The New Commerce*, which is to appear in the near future in five languages in order to provide a forum for the interchange of business opinion on an international basis, desires it to be distinctly understood that this enquiry has been concerned solely with the economic aspect of the reparation problem. The ethical bearing of the question—the overwhelming claims of Justice from the Allied point of view—is not here dealt with.

THE INDEMNITY AND ITS EFFECTS ON TRADE.

In considering the decisions of the Reparations Commission in relation to Trade, it will be convenient to divide the subject into two parts.

There is first the question whether the terms can actually be carried out, since strong economic arguments have been advanced to show that they cannot. The answer to this question involves an analysis both of the terms proposed and of the financial position of Germany.

Secondly, whether or no complete fulfilment of the conditions is realised, economic transfer on the scale contemplated cannot be without important effects on industry and commerce generally, and in particular on the exchanges. That any given result may be counteracted by other causes or by unforeseen developments does not affect the operation of the laws which primarily determine such movements.

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In discussing the possibility of payment a careful analysis of the findings of the Commission is necessary.

As regards the actual total it was decided that under the Treaty, Germany is liable for £6,850 millions (*gold*) of which £250 millions (*gold*) is the Belgian National Debt, which Germany is to take over. This sum includes the payments, about £100 millions (*gold*), which have already been made, in kind or otherwise; and from it are also to be deducted any sums credited to Germany in respect of State property in ceded territory or of payments made by other enemy powers.

In addition, Germany is, of course, liable for the expenses of the armies of occupation. The £100 millions asserted to have been already paid is what remains after deducting these costs up-to-date.

The methods by which it is proposed to raise this sum are somewhat intricate, but may conveniently be summarised under five heads :—

(*a*) Three series (A. B. C.) of bearer bonds are to be issued, on the security of German revenues. They are to be free from German taxation; and fears have been expressed that Germans will evade their income tax by buying these bonds. The bonds will be divided among the Allies, who can decide to negotiate them or keep them themselves. Series A for £600 millions (*gold*) and series B for £1,900 millions (*gold*) are to be handed over by July 1 and November 1 respectively, to bear interest at 5% and are to be redeemed at par by a 1% sinking fund. Series C for £4,100 millions (*gold*), less the deductions mentioned above and sums credited to Germany, *e.g.*, as a result of the Reparations Recovery

Act, will be issued as and when the Reparations Commission consider that the German payments are sufficient to provide 5% interest and 1% sinking fund.

(*b*) Germany is to pay £100 millions (*gold*) annually in quarterly instalments; and also every quarter an additional sum equivalent to 26% of her exports in the quarter before last. These payments are, of course, to be reduced when they exceed what is required for interest and sinking fund on all the unredeemed bonds. Germany's exports are taken as an index of her prosperity. The new German Chancellor is dissatisfied with this index, and hopes that some other will be devised which will be acceptable to all parties. One based on income tax returns would probably be more satisfactory, if adequate figures were available.

(*c*) Germany was to pay £50 millions by May 31, 1921, in gold on approved foreign securities, or guaranteed 3 months German Treasury Bonds payable at any place required by the Commission. On October 15 the first quarterly payment under the regular scheme is to take place.

(*d*) The bonds are to be particularly secured on the following revenues (or any alternatives accepted by the Committee of Guarantees), namely, all custom duties and especially a 25% export duty, to be reimbursed to the exporter by the German Government. From this, articles covered by the Reparations Recovery Act or similar legislation in other countries are to be exempted. Germany is to assist in working the Reparations Recovery Act and to reimburse her exporters, while payments received under the Act are to be made over to the Commission and credited to Germany. It is open to the Commission to use surplus payments to pay interest on unissued series C bonds, such interest not to exceed 2½% up to 1926 nor 5% after that year. (Otherwise the surplus payments would be used to issue more bonds.)

(*e*) Germany is, if the Commission approve, to provide material and labour to any Allied power on demand, the value of such material and labour being determined by valuers appointed by the power in question and by Germany; and in case of disagreement by an umpire appointed by the Commission.

Inquiry into the question whether in fact the terms can be carried out has elicited a number of interesting pronouncements. In particular, mention may be made of an address by the Right Hon. Reginald McKenna to the Institute of Chartered Accountants on June 15, in which the answer takes a qualified form of negation; and of the elaborate criticism directed against the financial clauses of the Treaty by Mr. J. M. Keynes, C.B., in his *Economic Consequences of the Peace*. We shall see reason in what follows to disagree with certain of the views expressed by both authorities.

We may conveniently note here that, although as Mr. McKenna points out, a 25% export duty on German goods would act as a bonus on her invisible exports such as shipping, insurance and banking, this would clearly not be the case if, as has been announced, the German Government is going to reimburse the duty to the exporters. The duty would then be merely a complicated method of collecting reparations from the German Government. This reimbursement was, in fact, one of the provisions of the ultimatum Germany signed.

CAN THE TERMS BE CARRIED OUT?

Germany can make her Indemnity payments in only three ways; by the transfer of gold and silver; by the transfer of securities; and by an excess of German exports (visible and invisible) over German imports. The first method may be neglected, because Germany's stock of precious metals is small; and it is recognised as inexpedient to remove it, owing to the probable effect on the mark. It may be mentioned that the amount of gold in the world at the present time can be taken as less than 2,000 millions—of which, according to Messrs. Samuel Montagu's *Weekly Review of Foreign Exchanges* (June 9, 1921), the United States commands about 35%. It would follow that the world's stock of gold is less than one-third of the total indemnity.

Securities, which could possibly be used for payment, fall into three kinds:—German government securities; German industrial securities; and foreign securities in German hands. The use of the first kind would mean that the German Government tried to finance itself by borrowing abroad. It is very doubtful whether it could successfully compete with the better secured Reparations Bonds, and in any case such a course would only aggravate the difficulty later on, when the interest had to be paid. The interest on German industrial securities sold to foreigners could only be paid by an excess of exports, and it may be added that this method was rejected as tending to create Allied interests in Germany. German shipping has already been ceded, and the only remaining alternative to an excess of exports is the sale of foreign securities held by Germans. It was estimated by Mr. Keynes that the amount of such securities available was at most £250 millions. It has been suggested that this is an under-estimate, since he calculated that there were £500 millions German investments in Russia, Austria Hungary, Turkey, Roumania and Bulgaria, and that these were now valueless. It is possible that such securities may recover some part of their former value; Russian investments have already made some recovery. The Germans are mobilising these assets, but the proportion of the total reparations payable by this means is evidently very small.

We are left then with the fact that the Germans must pay almost entirely with exports, and that the excess of exports over imports must be equal annually to £100 millions (*gold*) + 26% of the exports. Is this possible?

Before the War Germany imported £74 millions more than she exported. This means that her new annual foreign investments were more than counter-balanced by the profits of her shipping and foreign banking and the interest on her existing foreign securities. Her shipping has been confiscated, her foreign banking has almost ceased, and her foreign securities are to be sold or confiscated, so that she would be left under pre-war conditions with a considerable deficit. Of what commodities can Germany export more now than before the War? And of what can she import less? This question was considered by Mr. Keynes, who came to the conclusion that the export surplus could not exceed £100 millions annually, subject to the proviso that "if the Allies were to 'nurse' the trade and industry of Germany for a period of five

or ten years, supplying her with large loans, and with ample shipping, food, and raw materials during that period, building up markets for her, and deliberately applying all their resources and goodwill to making her the greatest industrial nation in Europe, if not in the world, a substantially larger sum could probably be extracted thereafter." The significance of the proviso was further emphasised by Mr. Churchill in his speech at Manchester on June 8 to the Manchester Chamber of Commerce:

> "If Germany during the next 40 or 50 years were able to pay her debts to everybody, she would by that process have become master of every market in the world. She would have become the greatest exporting nation ever heard of—almost the sole exporting nation of the world. She would have achieved that conquest on the basis of the most miserable industrial population, ground down under her heels. And if during the next 40 or 50 years the United States of America received all that was owing to her she would, in that process, have largely destroyed her export trade. She would have robbed her people of many of their essential arts and industries. She would have ruptured the whole completeness of her interior economy. Germany, the debtor nation, would be unhealthily active, and America, the creditor nation, unhealthily stagnant. Some day these simple truths will penetrate the minds of the great nations, and on that day they will, if they are wise, endeavour, as part of a gigantic operation beneficial to all, to reduce the mutual indebtedness of nations to limits which are not incompatible with healthy trade, normal exchanges, and with decent labour conditions." (Applause.)

Mr. McKenna, speaking just a week later, used language remarkably similar to that of Mr. Churchill. "The conclusion to which I am driven," he said (*The Times*, June 16), "is that if Germany is able to meet her obligations, she will, in doing so, gravely impair our own international trade"; and again.

> "Her highly developed manufacturing and commercial power brings her into direct competition with us more than any other nation in the world, and, whether she pays through visible or invisible exports, it is our trade that will be mainly affected."

The precise figure given is, however, not entirely convincing, because though Mr. Keynes repeatedly asserts that German exports must be diminished by the loss of Alsace-Lorraine, parts of Poland and Upper Silesia (which may ultimately not be lost to Germany) he never mentions the effect of losing these provinces on the amount of necessary imports; and the figure is admittedly a mere guess since it is almost impossible, and he does not attempt, to sum possible increases in numerous items, each of which is but a small proportion of the total exports, but which constitute taken together 53% of the total.

LOSS OF SURPLUS PRODUCTIVITY.

But Mr. Keynes also approaches the matter from another angle. He starts from Helfferich's estimate of Germany's annual

increment of wealth in 1913 as £400 millions to £425 millions (exclusive of increased money value of existing land and property). Before the War, Germany spent between £50 millions and £100 millions annually on armaments, and since this expenditure is no longer necessary, it might be concluded that there is no reason why she should not pay over to the Allies £500 millions annually. But this sum must be subjected to various deductions

> "The loss of Alsace-Lorraine, Poland and Upper Silesia could not be assessed in terms of surplus productivity at less than £50 millions annually. Germany is supposed to have profited about £100 millions per annum from her ships, her foreign investments, and her foreign banking and connections, all of which have now been taken from her."

Neglecting the burden of the internal debt as being a question of internal distribution rather than of productivity, Mr. Keynes considers that we must still allow for the foreign debt incurred by Germany during the war, the depletion of her raw materials and live stock, the impaired productivity of her soil, and the diminution of her wealth from the failure to keep up many repairs and renewals over a period of nearly five years. He puts the reduction under these heads at at least 10% or £40 millions, a very moderate figure.

So far we have £(500—100—50—40) = £310 millions annually. We have been working with pre-war money; but the surplus productivity of Germany is a matter not of money but of goods. To get the sum into gold, we shall therefore now have to multiply by 2—for a given quantity of goods is to-day exchangeable into approximately twice as much gold now as it was before the war—which Mr. Keynes forgot to do. So we have £620 millions (*gold*) annually.

But there is one more deduction which must be made on account of Germany's annual charge for pensions which amounted, when Mr. Keynes wrote, to 5 milliard marks. This he converted *at par* into £250 millions. The mark then stood at about 150 to the £, but fell in three months to 340; consequently he overestimated the actual burden of the pensions to the German Exchequer. But he thought that his figure did not overstate the real loss of national productivity as a result of casualties suffered in the war. It does, however, appear that it is an over-estimate, for we are considering surplus productivity, not productivity, and, though it is not clear what Mr. Keynes thinks, the figure would naturally be taken as present pounds gold, not pre-war pounds; so that, unlike the other figures, we shall not have to double it.

We therefore have £(620—250) =£370 millions (*gold*) annually instead of £100 millions. And Mr. Keynes has not yet allowed for the lowering in the standard of life and comfort that it is regarded as reasonable to impose on a defeated enemy. It is true, as he says, that such a lowering of the standard of life acts both ways on the surplus productivity; but it is difficult to believe that a considerable saving *could* not be effected in this respect.

But anyhow, he contends, the method of calculation by surplus productivity is entirely wrong; since a surplus available for

home investment can only be converted into a surplus for export abroad by a radical change in the kind of work performed.

> "Labour, while it may be available and efficient for domestic services in Germany, may yet be able to find no outlet in foreign trade. We are back on the same question which faced us in our examination of the export trade—in what export trade is German Labour going to find a greatly increased outlet? Labour can only be diverted into new channels with loss of efficiency, and a large expenditure of capital. The annual surplus which German labour can produce for capital improvements at home is no measure, either theoretically or practically, of the annual tribute which she can pay abroad."

But though the whole of this annual surplus is not available for reparations, a large part of it may be, and for it to be so available it need not necessarily take the form of increased exports. Decreased imports are a possible alternative. A large part of it must have been spent on transportable, and therefore exportable, commodities, such as machinery, and some of it before the war was invested abroad. During the war America is supposed to have built up credits abroad to the extent of £1,700 millions (*gold*) a year. The war has shown the elasticity of a modern industrial community—its power of adapting itself to changes in demand, of rapidly producing swords instead of ploughshares.

To Mr. Keynes' question, "In what export trade is German labour going to find a greatly increased outlet?" an answer may be given, "In none; but it will find an increased outlet in many trades, each of which is small, though taken together their volume is large. In 1913 53% of Germany's exports were in trades no one of which was 3% of her total exports." It is here assumed that we are willing to buy German goods as cheap as they will let us have them; the contrary hypothesis will be considered later. The conclusion we have come to is that Mr. Keynes' investigation is not altogether conclusive, and that the capacity of Germany may be considerably more than he supposes.

GERMANY'S OPTIMISM.

Let us now turn and look at the question from the point of view of the German Government, which has got to find the money. The task is admittedly one of extreme difficulty, even if it is regarded as possible.

The German Government is faced with a deficit for 1921 of 33 milliards + 12½ milliards for railways and posts, and probably + 9 milliards for expenses of the occupation which have not been. included in the budget, totalling in all 54½ milliards paper marks. The annual reparations payments, taking the German exports as £300 millions (*gold*), and one gold mark = 15 paper marks, will be 53½ milliard paper marks. The total deficit is, therefore, 108 milliards of paper marks. The income per head of the German people was estimated in a League of Nations memorandum as 95½ dollars, i.e., £20 (*gold*). This is not as low as might appear, because gold prices are lower in Germany than elsewhere; but it is less than half the similar figure for France, and less than ⅓ that for England.

How can 108 milliards more be raised? Complaints are made of extravagant salaries of officials, particularly in the cities, but the dismissal of 400,000 officials would only save 6 milliards. The income tax is already up to 60% on large incomes; the yield of income and property taxes together is only 18 milliards, and they cannot be increased six-fold as would be needed to raise 108 more milliards. The problem is, roughly, the trebling of the German revenues.

Nevertheless, the new German Government takes an optimistic view. It professes an anxiety to do all in its power to discharge its obligations and announces an imposing programme of taxation. A considerable revenue is expected from placing fresh burdens on property, which largely escaped the Erzberger property taxes of 1919. Property embodied in solid things which rose in price as the mark depreciated is taxed on its 1919 value in marks, which may well be but a small part of its present value. The owners of such property are called by Dr. Wirth (the Chancellor) "Reparations profiteers." Other sources of revenue are expected to be found in the difference between world prices and home prices, especially of coal; in taxes on land and on Stock Exchange transactions; in the abolition of subsidies and the taxation of beer, spirits, tobacco, sugar and sugar substitutes. Dr. Wirth hopes to impose such indirect taxation without raising prices to the consumer, but he did not explain how, and the Reichstag was clearly sceptical. Luxury imports are to be limited and productive work is to be found for the unemployed. There is to be no more currency depreciation.

With the aid of the sale of foreign securities, it should be possible to pay the first few instalments; whether the next payments after these will be possible at the dates specified is extremely doubtful, though, as time goes on, German resources will, of course, be greatly increased. The optimism of the German Chancellor is a good sign, for evidently it would be unwise to excite hopes that cannot be realised; and those who are unwilling to follow Mr. Keynes in his conclusion that Germany could pay £100 millions (*gold*) annually, or 26% of her exports, but not both amounts, must rely chiefly on such imponderables as this optimism.

REPARATIONS AND THE ALLIES.

THE IMMEDIATE FUTURE.

The first £50 millions (*gold*) to be received, mostly in bills due at the end of August, is not to be distributed among the Allies but to be used as a guarantee for interest and sinking fund charges in connection with the Series A bonds for £600 millions (*gold*) to be handed over on July 1st. £7,500,000 (*gold*) of this has already been received in actual dollars, as insisted on by the Commission. It appears, though this is not clear, that the remainder is also to be paid in actual dollars, and the German purchase of dollars has sent the dollar up. For this the Reparations Commission has been blamed, but its demand is reasonable, for dollars are the only currency with a gold basis, and the money from Germany may be largely used for payments in America. This can have no permanent effect on the exchange, since the Allies

would have had to make these payments in any case; and it is of some advantage that the dollars should be bought as far as possible before the autumn rise in the dollar. The only objection which can reasonably be taken is that the Commission has not made its intentions sufficiently clear to prevent uncertainty in the exchange market. The purchase of dollars is being left by the Commission to the Germans at their own desire, in accordance with the precedent of 1871.

We have therefore to expect the following influences on the exchanges in the near future. At present the dollar is rising owing to German purchases; the autumn swing will tend to raise it further. In the beginning of September the dollars paid to the Reparations Commission will (if not required for payments in America) be released and this will tend to lower the dollar, by about the amount the previous German purchases raised it. Even if they are required in their dollar form by the Commission, their transfer will tend to lower the dollar, since it will relieve the Allies from the necessity of buying dollars. The dollar is thought, however, to be going to rise again, on account of the U.S. Emergency Tariff and the expectation that America will be forced to revise her optimistic views as to the effects of the reparations settlement on European prosperity. It must be emphasized that this is not a prophecy of the course of the exchanges, but a statement of various forces which will act on them. These forces are liable to be counteracted by other forces not foreseen. All these questions are full of uncertainty and unknowns. Estimates of Germany's capacity to pay might, for instance, be badly shaken by a general strike in Germany, and prophecy in the economic sphere is for such reasons notoriously rash.

The Reparations bonds, when issued, are to be divided among the Allies in the proportions agreed to last autumn, France being allotted over 50%. Considerable interest attaches to the possibility of marketing these bonds. It is anticipated in some quarters that they will only be taken up in America if guaranteed by England and France, which would, however, tend to injure English and French credit; and in any case they may well be more than the international market will be able to absorb.

A report has been issued by a Commission of the French Senate (*vide Economist* May 28th) in which it is estimated that these 5% bonds will only be saleable on a 7% basis and so will only fetch 71% of their nominal value; and it is suggested that for the most part the bonds should be held back. Difficulties in the way of their mobilisation are pointed out. If a Frenchman buys these bonds and the franc should rise in terms of gold before they are redeemed, repayment at par in gold will mean a loss in francs. This difficulty, which frequently intrigues certain French journalists seems largely imaginary, for if the franc has risen, prices in terms of francs will presumably have fallen and the holder on redemption will not have a reduced purchasing power in goods.

THE INDEMNITY AND ITS EFFECT ON TRADE.

An indemnity of the present magnitude can, as we have seen, only be paid in exports. The extra German exports will compete with Allied industries, and the fear of great loss by this competition is widespread. We must examine the grounds of this fear.

Before the War the view was sometimes put forward that an indemnity must do harm to the country receiving it. This view which was associated with the earlier writings of Mr. Norman Angell, was based largely on the supposed consequences of the Franco-German indemnity in 1871. In 1873 there was a severe crisis in Germany, which France entirely escaped; but it is now recognised that it is wrong to attribute this surprising fact to the indemnity payment. A careful study of the question was made by Mr. H. H. O'Farrell, who came to the conclusion "that the indemnity played a small part, if any, in aggravating the financial troubles under which Germany, in common with the rest of the world, suffered in the ten years which followed the conclusion of peace." This conclusion was, as Lord Esher pointed out in his introduction to Mr. O'Farrell's study, contrary to the views put forward by Mr. Angell. The severe crisis of 1873, whose foci were Austria and the United States, did not affect France, because, as Mr. Hawtrey has shown, in 1871 as in 1814 the terrors of invasion had reduced credit operations in France almost to vanishing point. In each case she thus escaped the crisis in neighbouring countries; for it is a necessary condition of a crisis of any gravity that a serious proportion of the country's trade should be financed by temporary borrowing.

An indemnity is the same from the economic point of view as a form of international indebtedness; so that at first sight, the recipients of indemnity are in the position of creditor nations. and no one disputes that foreign investments are a most advantageous source of a nation's income. Mr. O'Farrell claims to show a difference between indemnities and foreign investments, and holds that in the case of an indemnity there is a "reverbatory shock." All nations dealing with the victim will be forced to pay more for their imports from her, owing to the additional burdens imposed by the indemnity on the industry of the vanquished country. It is true that a Carthaginian, or purely punitive, peace designed to cripple Germany, damages her industry and so harms all who buy from her; but the exaction of a payable indemnity must leave quite a contrary effect. To pay the indemnity the victims are obliged to export more, which they can only do by accepting less in return. So we shall obtain German goods at less expense than formerly. Germany will lose (and Allied consumers will gain) through this fall in value of the goods she exports—a fall which will show itself in a fall in the mark, or a fall in prices here, or a rise in prices in Germany.

But this fall in the international value of the commodities exported by Germany will affect adversely exporters in other countries of similar goods. In particular, since, as Mr. McKenna has pointed out, the same class of goods—namely, iron and steel products, machinery and parts thereof, woollen and cotton goods, and coal—constituted before the war 40% of German exports and 70% of British exports, this effect of reparations of lowering the value of Germany's exports will hit Great Britain hard. But it will hit her, qua competitor of Germany in foreign markets, not qua recipient of reparations, so, for the present, we may neglect it, in order to confine ourselves to the simpler case of indemnity

economics in which there are only two countries, the payer and the payee.

THE ECONOMICS OF INDEMNITIES.

There certainly is an important difference between an indemnity and foreign investments. The latter arise gradually as the result of saving, the former suddenly as the result of an ultimatum. Any sudden economic change means some dislocation, and is bound to have some unfortunate consequences; just as inventions mean loss to manufacturers who continue in the old way. Such a loss is, however, only temporary for it is due to the imperfect mobility of capital and labour.

It is important to realise that this loss is of a temporary nature The Germans, it is clear, can only pay by increasing their exports and it is concluded that this means the destruction of the market for our industry. But while admitting that considerable damage is inevitable, we may notice that theoretically these exports cannot in the long run substantially reduce the demand for commodities in general, as opposed to the demand for the particular commodities we are anxious and able to produce. It may, in fact, be necessary to alter our production and make something else, but there is sure to be a demand for *something;* for the demand which we shall lose will be offset by the increased demand in Allied countries of those who receive and in some way spend the reparations payments. For whatever use these payments are put to, they will swell the world demand for goods. If, for instance, they are used to restore the devastated areas, there will be an increased demand in the building industry. Or they may be used to pay off debt or to lower taxation, and the public will then have less taxes to pay and so more to spend on other things.

As an illustration, the British share of the indemnity will roughly pay the interest on our national debt to America, which means that, so far as we are concerned, the indemnity merely shifts this debt from us to Germany. Otherwise England could only pay the interest on the debt by increasing her exports. This she will no longer need to do. Her exports will be less, but the burden of taxation will be less too, and the public will buy more of other things. England will be able to consume this surplus herself, instead of sending it to America as interest on debt. Owing to improved circumstances, people in England may possibly not work so hard because they will have less need to. This might be regarded as a decline in British industry, but would only be regretted by those who think work desirable on its own account—the Sisyphists as Bastiat called them.

THE DISLOCATION OF INDUSTRY.

The problem is the production of something else; for to establish equilibrium, the goods produced by different nations must be roughly complementary. If this were the case apart from reparations payments (which it is not), equilibrium might be destroyed by such payments. For the payments are a transference of purchasing power from Germany to the Allies, and it is possible that the Allies will not buy with that purchasing power exactly what the Germans would have bought. A new equilibrium will be required, and someone or other will have to produce "something else." This is easier said than done, but

it can be done more easily than may at first sight appear. At the beginning of the war, though doubtless under special psychological and administrative conditions, all the belligerents rapidly produced "something else," in the form of munitions and armies. All swift changes, as has already been noted, mean loss to some producer, and owing to the depressed exchanges there is in any case no equilibrium, so the problem is there anyhow. The payment of reparations delays equilibrium and so aggravates the difficulty; but sooner or later equilibrium must be reached. The object of the Safeguarding of Industries Bill at present under discussion in England is to ease the transition, and the matter is one requiring great detailed knowledge. If in all countries there were administrations whose wisdom and information commanded confidence, and which could be trusted to view things impartially rather than from the point of view of some influential group, whether of capital or labour, there would be a very strong case for temporary Protection at the discretion of the executive. But as things are and in view of the difficulty of abolishing or reducing a tariff once imposed, the Free trade case is a strong one, since universal free trade involves at least a rapid attainment of equilibrium, except in so far as this may be prevented by general disorganisation and lack of confidence.

Free trade has been curtailed in two ways: by protective legislation and anti-dumping bills, whose results are still uncertain; and in another way which may definitely be said to have failed. At the time of the Treaty there were certain commodities of which it then seemed that the Allies could not have too much. Clauses were therefore inserted in the Treaty giving the Allies options on certain German goods, both then existing and to be produced later. Among such commodities were shipping, coal, machinery, dyestuffs and labour. Mr. McKenna is a believer in this policy, but though he suggests as suitable commodities coal, timber, potash and sugar, he does not think much could be paid in this way. For a commodity to be really suitable, however, from this point of view, it would, unless in the hands of an omniscient government, have to be something of which Germany has a monopoly and which the Allies do not wish to produce themselves. In other words, every commodity suggested will be found to be open to grave objections, quite apart from possible mismanagement. If, however, it were feasible for the Allies to secure from Germany material and labour to erect public buildings, which would not otherwise have been undertaken—the Continuation schools, for example, which for 20 years have been so essential a factor in Germany's commercial expansion, but which English municipalities are still unable to afford—some payment might be effected in this way without loss to any Allied producer. We have had two years' experience of the working of these clauses and may agree with Mr. J. F. Dulles, (formerly Counsel to the American Peace Commission) whose conclusions are set forth in the current number of *The Economic Journal*, that they have by no means proved an unmixed blessing.

German shipping had almost all to be surrendered, and Germany was further obliged to build ships for the Allies at a certain rate. Britain has now more shipping than she wants; her shipyards are

idle and the competition of cheap ex-German shipping has forced many British ships to lie up. The Allied experts now recommend that no more ships should be demanded from Germany and that some already taken should be returned. But apart from the damage done to Germany in hampering her exports and otherwise, and so indirectly to the rest of the world, Allied interests should not have been much damaged. The surrender of German shipping enabled Britain to profit by the shipping boom, without diverting so much capital and labour as would otherwise have been the case. This was an advantage, because such diverted capital and labour would have suffered in the inevitable slump. If, however, the requisition of German ships meant that more ships were built than would otherwise have been the case, it may have hastened the slump.

The demand that the Germans should sell coal to France below the market price has injured the British export coal trade in a very evident manner, and has further had the effect of subsidising French competition with British industries. What will happen when the Lens coalfield is reconstructed and this cheap German coal comes into competition with French coal remains to be seen. Very little use has been made of the option on German machinery, for the installation of German machinery in Northern France was considered dangerous, as it would probably have involved that spare parts for many years would have to be obtained from Germany. As regards German dyestuffs, far from encouraging their importation the Allies have mostly passed legislation designed to keep them out.

In spite of these examples, Mr. McKenna, as we have seen, wants to throw the burden of producing "something else" on to Germany by demanding from her goods complementary to, not competitive with, those produced by Britain. But even if this were possible and could be scientifically carried through, it is by no means certain that such a policy would diminish the waste due to dislocation, or lay all the burden on Germany, since a large part of it might be transferred to the consumers of German goods in increased prices. The Free Trade alternative of allowing economic forces to determine the means of payment would mean that something substantial was secured by way of reparation, but would correspondingly strengthen Germany's economic position. By Mr. McKenna's method it is most unlikely that as much would be paid as would be to the interest of the Allies.

THE BRITISH POSITION.

What goods Great Britain would require from Germany could not easily be estimated beforehand, because her demand for extra goods would arise from the remission of taxation attending the receipt of reparations, and might be divided into a great variety of small items. If the Chancellor of the Exchequer budgets for £50 millions from Germany, he can raise £50 millions less from the British public in taxation. The £50 millions which would have gone in taxes could be used by this public in buying extra German exports, the sale of which enables Germany to pay the aforesaid £50 millions reparations to Britain.

In practice things would not happen quite so conveniently as this, for there would be some dislocation, though, as has already

been urged, of a temporary nature. The loss due to this dislocation could not be easily measured, but it is difficult to see how it could equal the direct gain to the Allies represented by the Indemnity. In addition to this, British exporters who compete with Germany will lose by the fall in value of German exports due in part on the payment of reparations.

Mr. McKenna appears not to allow nearly enough for the great burden on German industry which will be inflicted by the extra taxation necessary for the payment of reparations. He does not refer to it, except as regards the 25% export duty which, for the next few years, is about a third of the whole sum. The plight of British exporters would be bad indeed if the hardships undergone by the Germans resulted in a correspondingly great decrease in cost of production. But if this were the case, no surplus would be available from which the German Government could pay the £100 millions annually. The German Chancellor hopes to raise a large part of the necessary extra revenue out of the difference between world prices and German prices, and this will obviously reduce the amount by which German exporters can undersell the British.

If in spite of these allowances this loss to Great Britain is not counterbalanced by her share of reparations, then the question would arise to what extent France was prepared, in the interests of Britain, to forego the reparations she so badly needs for the restoration of her devastated regions. There may be on this point a considerable divergence of interest between the Allies. The difficulty is one which Britain can do little to remove by protection, for it is the fall in value of the commodities which both she and Germany export that constitutes the real problem.

Loss under this head to British manufacturers through reparations will, as we have seen, be less than Mr. McKenna supposes. In any case, it tends to be greatly exaggerated by confusion with the loss (which is independent of any reparations settlement) due to the depression of the Central European exchanges. It is evident that, what enables the German manufacturer to undersell the English is not the fact that Germany has to make reparation, but partly her educational and technical efficiency and the willingness of the German worker to accept low wages, and partly the depression of the exchanges. The low prices resulting from the fall of the mark have given the German producer a great advantage. He can only be prevented from using this advantage by curtailing the further increase of Germany's exports, which means a corresponding loss of reparations. If, however, a free trade policy prevails, it would presumably pay the Allies from a purely financial standpoint to exact all the reparations they can obtain, for prices should soon adjust themselves so as to deprive the German producer of his advantage. But this involves that, if the German Government is thus allowed to continue payment, and thereby to make use of the obvious patriotic appeal to increase and cheapen production, the productive power of Germany will, as Mr. Churchill so eloquently pointed out in the passage quoted above, attain stupendous dimensions. The scientific research, the technical developments, and the industrial and educational organisation

which she recognised as the secret of her success before the war, would in these circumstances be immensely stimulated. Her productive capacity would be such that, in the event of further recourse to hostilities, she might well prove invincible.

It may here be observed that to talk about reparations as if the acceptance of them by Britain implied her willingness to live on her late enemies, and to become a *rentier* nation, with no means of subsistence when the reparations ceased, is a great exaggeration. The reparations payments to Britain will at first roughly balance her debt to America; and could not by themselves restore the credit or position she held before the war. Further, the reparations payments will (or could be made to) cease gradually as the bonds are redeemed, and this should give ample time for the necessary expansion of her industry. So the conclusion of the payments should cause no such dislocation as their beginning. The risk of such a loss of capacity is more of a menace to America than to any other country, as the creditor nation *par excellence*.

THE ABILITY TO RECEIVE.

Mr. Dulles considers that in the light of our recent experience the reparations question has been transformed. It is no longer "how much can Germany pay?" but "how much can the Allies afford to receive?" He thinks that the failure to utilise these various options shows that the Allies are not prepared to receive great quantities of goods from Germany direct. Perhaps, however, a distinction should be made between willingness to receive goods exacted compulsorily below the market price and willingness to receive goods under free trade conditions. But the revival of Protection in Great Britain seems to show that she is unwilling to receive great quantities of German goods in any way.

There is also the possibility that the Germans should pay by exporting more to America, but this is hardly compatible with the Emergency Tariff, and in every quarter we are faced by the remarkable fact that the Allies do not feel disposed to receive further surrenders. The time has clearly come for a careful consideration of the question; for if the Allies will not receive German goods, they are cutting off her only means of payment, and the Treaty cannot be carried out. There will be another breakdown, another appeal to the "sanctions." If no means can be devised whereby the Allies can profit from German surrenders, then for the sake of peace and the recovery of Europe, they may have to reconsider their original demands.

The present state of the exchanges and the consequent disparity between prices in Central Europe and prices elsewhere are a standing menace to British prosperity. The very low estate to which the mark has fallen, says Mr. Dulles, is evidence that the world does not want that which the mark can procure—German goods, German labour or German investments. After a war, or in a slump, this is doubly natural, but historians have noted that the world does not always want what is good for it. It fears the Greeks even when their gifts are genuine. It cannot, however, afford to remain permanently without the advantages offered by the recovery of Central Europe.

SUMMARY.

To sum up:

Our discussion which began by considering the possibility of carrying out the terms, apart from their effect on trade, found that opinion was divided on this point, the apparent determination of the German Government to fulfil their agreement being set against the high authorities on the other side.

Assuming that the payments proceed, two quite distinct inquiries emerge which are dealt with conjointly:

(*a*) The immediate effect of such payments on the exchanges, and on the trade of the Allies collectively and in particular

(*b*) The desirability or otherwise of allowing the payments to continue in view of their consequences; and arising out of this the possibility of devising any form of indemnity which will avoid the disadvantages involved in the present arrangements.

The immediate fluctuations of the dollar, in which payments is to be made, are seen to be of minor importance in comparison with the ultimate effect of the reparations on Allied trade. It was found that economic disturbances after the Franco-Prussian war were too readily attributed to the indemnity, and that we are liable to fall into the same error to-day, attributing to reparations the natural dislocation due to the events of the past seven years.

We have seen that the payments may aggravate this dislocation, and the necessity for Germany to increase her exports will lower the international value of the commodities exported, which would involve some loss to other manufacturers of these commodities. It is, however, unlikely that the damage due to reparations under these heads will nearly counter-balance the direct profit to the Allies as a whole.

Passing now to (*b*) we observe first that payment can only be obtained by abstaining from a protectionist policy. If, however, such a policy is adopted, it is essential that the demands should be revised, for trade cannot be prosperous if confidence is liable to be again shaken by the threat of an appeal to force.

Looking to the prosperity of Europe as a whole, it does not appear that it can be increased by any reparations payments from Germany to Britain; such payments are transfers of wealth from the poorer to the richer country. This is a strong economic argument against such transfers, and there is also the extra dislocation which, as we have seen, they may cause, thereby aggravating the difficulty due to the depression of the exchanges in attaining equilibrium.

More doubtful is the question of reparations from Germany to France. Germany is at present poorer than France, but her resources in the long run are greater; these two considerations are difficult to balance. The question is, however, of purely academic interest, for it is not expected that the Allies' decisions will be based on the interests of Europe as a whole, but rather on those of the Allies themselves. The economic interests of France probably lie in receiving all she can get; for to her the condition of her finances is more important than any possible resulting dislocation. But with

England the matter is not so clear ; considerable fear is entertained of damage to her industries by German competition, and by supplying an incentive to the German worker to lower his standard of life, the exaction of an indemnity may accentuate this danger. Nor can the prospect of an all-powerful Germany in forty years time be viewed with equanimity by Great Britain or by France. The alternative suggestion of demanding specific commodities, though free from these objections, would probably not result in any considerable payment and would lend itself easily to mismanagement. The economic interests of the United States, it may be noted in conclusion, are bound up with the prosperity of Europe as a whole, except in so far as her loans give America a special interest in the Allies.

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